

09-3324

AUDIT

TAX YEAR: 2006

SIGNED 05-05-2010

COMMISSIONERS: R. JOHNSON, M. JOHNSON, D. DIXON, M. CRAGUN

GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,	INITIAL HEARING ORDER
Petitioner,	Appeal No. 09-3324
v.	Account No. #####
AUDITING DIVISION OF THE	Tax Type: Income Tax
UTAH STATE TAX COMMISSION,	Tax Years: 2006
Respondent.	Judge: Nielson-Larios

Presiding:

Aimee Nielson-Larios, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER, *pro se*
For Respondent: RESPONDENT REP. 1, Utah Assistant Attorney General
RESPONDENT REP. 2, Auditing Division
RESPONDENT REP. 3, Auditing Division

STATEMENT OF THE CASE

This matter came before the Commission for an Initial Hearing pursuant to Utah Code § 59-1-502.5 on April 8, 2010. On October 22, 2009, Respondent (the “Division”) issued a Notice of Deficiency and Audit Change (“Statutory Notice”) to Petitioner (the “Taxpayer”), in which the Division imposed additional tax and interest as follows:

<u>Year</u>	<u>Tax</u>	<u>Penalties</u>	<u>Interest</u>	<u>Total</u>
2006	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

Interest has continued to accrue. The audit tax was primarily based on an addition to income of \$\$\$\$\$ for the state tax the Taxpayer deducted on his federal Schedule A.¹ The Taxpayer contends that he is not required to add the state tax deducted to his state return because he deducted state sales tax, not income tax, on his federal

¹ The Statutory Notice also indicated an adjustment increasing by \$\$\$\$\$ the Taxpayer’s deduction for one half of his federal tax. Neither party addressed this change during the hearing.

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Schedule A. Prior to the hearing, the Division asked the Taxpayer to submit his receipts showing the sales tax deducted. However, the Taxpayer refused because he believes that the Division is exceeding its authority with this request.

DISCUSSION

During the Division's audit, the Division proposed a \$\$\$\$ audit change based on the Taxpayer's federal information, which showed the \$\$\$\$ amount as "[s]tate and local income taxes" on the Taxpayer's federal return, Schedule A, Line 5. In response, the Taxpayer told the Division that the \$\$\$\$ amount was for state sales tax, not income taxes. The Division then requested the Taxpayer to provide his sales tax receipts, and the Taxpayer refused because he believed the Division was exceeding its authority. Consequently, the Division issued the Statutory Notice, identifying an adjustment for "State Tax Deducted On Federal Schedule A," which changed the amount from \$\$\$\$ to \$\$. The Division's change corresponds to Form TC-40, Line 5, titled, "[s]tate income tax deducted as an itemized deduction on federal form 1040, Schedule A, line 5."

State Tax Deduction

In support of his testimony that he deducted sales tax on Schedule A, the Taxpayer provided evidence that he had consistently deducted general sales taxes for the years 2005, 2007, and 2008. The Division had no evidence that the Taxpayer either intended to deduct state income taxes on Schedule A of the federal form 1040, or that the amount shown on Schedule A was the amount of state income tax withheld from his salary. IRS Publication 600 State and Local General Sales Taxes instructs taxpayers to "enter "ST" on the dotted line to left of the line 5 entry space." There is no evidence that the Taxpayer did so in this case. However, the failure to enter a notation does not disprove the Taxpayer's testimony. Furthermore, the Commission believes the Division could have researched the Taxpayer's state withholding to determine whether there was a correlation between it and the amount of the state tax deduction on Taxpayer's federal Schedule A.

The Commission is persuaded that the Taxpayer intended to deduct sales tax. However, because the Taxpayer refused to provide his receipts to support the amount of the sales tax deducted, the Division shall adjust Line 8 of the state return and remove the addition to income for state income taxes on line 5 of the state return. Under federal law, a taxpayer without receipts may deduct a sales tax amount calculated according to the tables provided in IRS Publication 600 (2006). Accordingly, the Division should recalculate the amounts shown on Lines 5 of the Taxpayer's federal Schedule A to reflect a sales tax deduction according to the tables listed in IRS Publication 600 instead of the amount provided by the Taxpayer. The deduction on Line 8 of the state return should also be corrected to show the same amount as the adjusted Line 28 of Schedule A, which

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corresponds to Line 40 of the federal tax return. After making this correction on the state tax return, Form TC-40, the Division shall recompute the Taxpayer's Utah taxable income and income tax.

Authority to Require Receipts

The Taxpayer contends that he correctly followed the instructions for the federal and state returns, so he has done all that he is legally obligated to do. He argues that he is not required to submit his receipts to the Division to prove that he deducted state sales tax, not state income tax, on his federal return. He asserts that he has the receipts but the Division is exceeding its authority by requiring them. He believes his situation is comparable to that of a driver being stopped by a police officer who wants to search the car.

The Division recognizes the Taxpayer's arguments as being constitutional in nature, and the Division responds that it does not believe that the Division engaged in an unlawful search. The Division argues that Utah Code Ann. § 59-10-501 (2006)² and Utah Admin. Code R861-9I-18 (2006-2009) require taxpayers to keep records and make such records available to the Division for review or audit.

The Utah statutes and rules require the Taxpayer to keep records and to "open [those] records for examination at any time by . . . the commission." § 59-1-1406(1). The Division has authority to request the receipts under § 59-1-1406(3) to "ascertain the correctness of a return." No statutory or case law was presented to suggest that the Division's request was unconstitutional. It may be noted, though, the Utah Supreme Court has found that "it is not for the Tax Commission to determine questions of legality or constitutionality of legislative enactments." *Nebeker v. Utah State Tax Comm.*, 2001 UT 74.

Burden of Proof

The Taxpayer argues that the burden of proof is on the Division because the Division is accusing him of fraud. *See* Utah Code Ann. § 59-10-543(1) (2006).³ The Taxpayer relies on a definition of fraud from the *American Heritage Dictionary*. The Division argues that the burden of proof is on the Taxpayer because the Division has not accused the Taxpayer of fraud. The Division stated that it has not assessed any penalties for fraud, which are provided for in Utah Code Ann. § 59-1-401(7)(a)(iv).

Section 59-1-1417 states:

In a proceeding before the commission, the burden of proof is on the petitioner except for determining the following, in which the burden of proof is on the commission:

(1) whether the petitioner committed fraud with intent to evade a tax, fee, or charge . . .

²The current version of § 59-10-501 (2006) is located at Utah Code Ann. § 59-1-1406.

³The current version of § 59-10-543(1) (2006) is located at Utah Code Ann. § 59-1-1417.

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The issue before the commission is to determine whether the audit assessment is correct. That audit assessment involves tax and interest, but no penalties for fraud. Furthermore, the Statutory Notice does not use “fraud,” “fraudulent,” or any similar terms. Thus, the Commission is not determining “whether the [Taxpayer] committed fraud.” The burden of proof remains with the Taxpayer.

Notice

The Taxpayer also argues that the Division failed to provide proper notice of its request for receipts. He contends that during the audit the Division was challenging the *magnitude* of the Taxpayer’s sales tax deduction, not just whether the Taxpayer deducted sales tax rather than income tax. The Taxpayer asserts the Division was required to request the receipts in writing, not just verbally. However, the Taxpayer provided no statutory or case law to support his claim. Furthermore, § 59-1-1406 does not include a notice requirement even though that statute provides that the commission has authority to examine a taxpayer’s books and records. Utah Code Ann. § 59-1-1405 is a statute requiring notice; however, this statute was met through the Statutory Notice mailed to the Taxpayer. Thus, there is no indication that the Division provided improper notice.

Conclusion

The Taxpayer has shown that the Division’s audit assessment is incorrect. In the assessment, the Division revised the “State Tax Deducted on Federal Schedule A” for Utah Form TC-40, Line 5. Because the Taxpayer did deduct sales tax, the Division should now revise its adjustment of Line 5 back to \$\$\$\$ and revise the “Standard or itemized deduction amount” on Line 8 to reflect a sales tax deduction calculated according to the tables in IRS Publication 600 (2006).

DECISION AND ORDER

Based upon the foregoing, the Commission instructs the Division to revise its assessment, reversing the amount assessed on Line 5 and adjusting the amount on Line 8 to reflect a sales tax deduction calculated according to the tables in IRS Publication 600 (2006). The state income taxes are to be recalculated to reflect these adjustments. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

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Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2010.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Notice: If the Petitioner does not request a Formal Hearing within the thirty-days as discussed above, failure to pay the amount of deficiency that results from this order may result in an additional penalty.

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